Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Core Communications, Inc.	)	WC Docket No. 03-171
	)	
Petition for Forbearance Under	)	
47 U.S.C. § 160(c) from Application of	)	
the ISP Remand Order	)	

PETITION FOR RECONSIDERATION

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PETITION FOR RECONSIDERATION

Pursuant to Commission Rule 1.429, SBC Communications Inc. ("SBC") respectfully requests that the Commission reconsider its October 18, 2004, decision to eliminate the growth cap and new market rule for ISP-bound traffic,[1] granting in part the relief requested by Core Communications, Inc. ("Core") in its Petition for Forbearance.[2]

I. INTRODUCTION AND SUMMARY

The Commission adopted the growth cap and new market rule in the *ISP Remand Order* as part of a regulatory strategy to eliminate the market distortions and regulatory arbitrage opportunities created by application of per-minute reciprocal compensation for ISP-bound traffic.[3] The Commission found that application of reciprocal compensation for such traffic undermined the operation of competitive markets by enabling CLECs to recover a disproportionate share of their costs from other carriers, rather than their ISP customers.[4] The

[1] Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order, *Order*, WC Docket No. 03-171, 19 FCC Rcd 20179 (2004) ("Core Forbearance Order").

[2] Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order, WC Docket No. 03-171, (filed July 14, 2003)("Core Forbearance Petition").

[3] Intercarrier Compensation for ISP-Bound Traffic, CC Docket No. 99-68, *Order on Remand and Report and Order*, 16 FCC Rcd. 9151 (2001)("ISP Remand Order"), *remanded, WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 1012 (2003).

[4] *Id.* at para. 71.

Commission therefore determined that it should transition to a bill-and-keep regime for ISP-bound traffic to eliminate arbitrage opportunities and force carriers to look to their own customers for cost recovery.[5] But, out of concern that a flash cut to bill-and-keep could have serious repercussions on carriers that had come to rely on reciprocal compensation for ISP-bound traffic to recover their costs, the Commission devised an interim compensation regime to lengthen and soften the transition to bill-and-keep while the Commission completed the *Intercarrier Compensation NPRM* proceeding.[6] Under this regime, the Commission imposed a gradually declining cap on reciprocal compensation rates for ISP-bound traffic (the "rate cap"), as well as a cap on the total number of ISP-bound minutes for which a LEC could receive compensation (the "growth cap"), and the "new markets" rule, which required a CLEC that sought to exchange ISP-bound traffic with an ILEC that had opted into the federal regime to exchange such traffic on a bill-and-keep basis during the transition if the two carriers had not previously exchanged traffic in a particular market.[7]

In the *Core Forbearance Order*, the Commission eliminated two of the pillars of the interim regime for ISP-bound traffic – that is, the new markets rule and the growth cap. The Commission justified its decision on the grounds that market developments (namely, a purported drop in dial-up ISP subscribers) had eased the concerns that led the Commission to adopt these rules, and thus that any such concerns now were outweighed by competing concerns that the rules might distort competition by allowing some, but not other, carriers to obtain compensation for ISP-bound traffic.[8] As discussed below, however, the evidence in the record established that, even if the number of dial-up subscribers has declined, the level of dial-up ISP minutes has not,

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[5] *Id.* at paras. 74-75.

[6] *Id.* at para. 78.

[7] *Id.* at para. 81. The Commission required any ILEC seeking to take advantage of the interim regime to agree to exchange all section 251(b)(5) traffic at the rates set forth in the order. *Id.* at para. 89.

[8] *Core Forbearance Order* at paras. 20-21.

and the total number of dial-up ISP minutes now is substantially higher than it was when the Commission adopted those rules. As a consequence, the risks of market distortions and regulatory arbitrage opportunities resulting from intercarrier compensation for ISP-bound traffic are, if anything, greater than they were when the Commission adopted the *ISP Remand Order*. The Commission's decision to eliminate key elements of its strategy to minimize, if not eliminate, those risks thus is unsupported by the record and internally contradictory. Accordingly, the Commission should reconsider its *Core Forbearance Order* and reinstate the growth cap and new markets rule established in its *ISP Remand Order*.

If the Commission nevertheless does not reinstate the growth cap and new markets rule, it should offset the impact of eliminating those rules by reducing the rate that carriers can charge to terminate ISP-bound traffic, and thus remain faithful to the principles underlying the *ISP Remand Order*. At a minimum, it should require any carrier that seeks compensation for ISP-bound traffic that would not have been compensable under the growth cap or new markets rules to accept a lower rate for terminating all ISP-bound traffic.

II. BACKGROUND

On July 14, 2003, only two years into the transition to bill-and-keep established by the Commission in its *ISP Remand Order*,[9] Core filed a petition requesting that the Commission forbear from "applying the provisions of the *ISP Remand Order* to the exchange of ISP-bound traffic between telecommunications carriers."[10] In its *Core Forbearance Order*, the Commission rejected all of Core's arguments for forbearance from the *ISP Remand Order* and specifically found that Core had not satisfied the requirements for forbearance under 47 U.S.C. § 10. Nonetheless, *sua sponte*, the Commission granted forbearance from the *ISP Remand Order's* growth cap and new markets rule. The Commission granted forbearance not only for Core, but

[9] Intercarrier Compensation for ISP-Bound Traffic, CC Docket No. 99-68, *Order on Remand and Report and Order*, 16 FCC Rcd. 9151 (2001)("ISP Remand Order"), *remanded*, *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 1012 (2003).

[10] *Core Forbearance Petition* at 1.

the entire CLEC industry. It did so, moreover, for reasons never presented by Core or any other party to the proceeding and without support for the factual premises underlying its decision. The Commission's decision to grant forbearance contravenes the very public policy goals enunciated by the Commission in its *ISP Remand Order*—goals which the Commission did not repudiate, and in fact reiterated even as it granted forbearance. The Commission's decision thus produces a result that cannot be justified by its prior and current policy determinations for intercarrier compensation generally and ISP-bound traffic specifically. For those reasons, the Commission should reconsider its *Core Forbearance Order*.

III. ARGUMENT

The *Core Forbearance Order* is unsupported by evidence in the record, is fundamentally inconsistent with the Commission's basic policy goals for intercarrier compensation, and is a major step back from the Commission's avowed objective of eliminating the regulatory arbitrage opportunities afforded by intercarrier compensation payments for ISP-bound traffic. There simply is no basis for eliminating two of the mechanisms the Commission put in place only three years ago to move to bill-and-keep for ISP-bound traffic.

It was precisely because intercarrier compensation payments for ISP-bound traffic "created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets,"[11] that the Commission created the compensation structure for ISP-bound traffic in the *ISP Remand Order*.[12] Although, the Commission acknowledged that such distortions "may result from any intercarrier compensation regime that allows a service provider to recover some of its costs from other carriers rather than from its end-users," the Commission correctly concluded that "[t]he regulatory arbitrage opportunities associated with intercarrier payments are particularly apparent

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[11] *ISP Remand Order* at para. 2.

[12] Indeed, the lure of payments for ISP-bound traffic is so strong that, even under the reduced rates of the Commission's *ISP Remand Order*, CLECs still terminate more than *nine times* more traffic than they originate to SBC.

with respect to ISP-bound traffic . . . because ISPs typically generate large volumes of traffic that is virtually all one-way[.]"[13] More specifically, the Commission found that, as long as its intercarrier compensation regime fails to reward efficiency and produces retail prices that do not reflect the costs of providing service, it will continue to "undermine[] the operation of competitive markets"[14] and constitute a barrier to sustainable competition.[15] It found that systems based largely on carrier payments cause market distortions by divorcing costs and revenues from end-user payments.[16] The Commission thus issued its *ISP Remand Order* because the application of its reciprocal compensation rules to ISP-bound traffic created a "pressing problem that has created opportunities for regulatory arbitrage and distorted the operation of competitive markets."[17]

To remedy these problems, the Commission in its *ISP Remand Order* made clear its intent to have moved by now to a "complete bill and keep recovery mechanism."[18] Although the Commission stopped short of immediately imposing bill-and-keep, it nonetheless found "a need for immediate action with respect to ISP-bound traffic,"[19] while finding that "bill and keep appears the preferable cost recovery mechanism for ISP-bound traffic because it eliminates a substantial opportunity for regulatory arbitrage."[20] To that end, the Commission described its compensation regime for ISP-bound traffic as "a transition toward . . . a more rational cost

[13] *ISP Remand Order* at para. 2.

[14] *Id.* at para. 71.

[15] *Id.* at para. 81.

[16] *See id.* at paras. 2 - 6.

[17] *Id.* at para. 81; *see also id.* at para. 71.

[18] *Id*. at para. 7.

[19] *Id.*

[20] *Id.* at para. 6.

recovery mechanism under which LECs recover more of their costs from their own customers," *i.e.*, bill-and-keep.[21] The growth cap and new markets rule are integral components of the transition mechanism the Commission established to move to bill-and-keep.

The Commission's decision in its *Core Forbearance Order* to reverse course and eliminate the growth cap and new markets rule is unsupported by any evidence in the record. The sole basis for the Commission's *sua sponte* forbearance decision is its determination that the expansion of arbitrage opportunities created by compensation for ISP-bound traffic is "not likely to occur given declining usage of dial-up ISP services."[22] There is no support in the record, however, for the factual premise underlying the Commission's determination. Specifically, there is no support for the premise that dial-up ISP minutes have declined since the *ISP Remand Order*, or that they will decline in the future. To the contrary, as discussed below, ISP-bound minutes have increased substantially since 2001 and are projected to increase in the future. The Commission's *Core Forbearance Order* is thus based on a mistake of fact and warrants reconsideration.

The only evidence relied upon by the Commission to support its assumption of declining ISP-bound minutes is a research report that shows a projected 22% growth in DSL revenue through 2008 and a June 2004 Commission report that shows an increase in the number of high-speed Internet access lines from 1999 through 2003.[23] Neither report, however, shows that dial-up ISP-bound minutes have declined since 2001 or that they will decline in the future. Even assuming *arguendo* that an increase in DSL revenues and subscribership implies a decrease in the number of dial-up subscribers, it is certainly not the case that such data say anything about trends in dial-up *minutes.* It is entirely possible that a smaller base of dial-up subscribers would spend more time on-line, particularly as more and more people incorporate the Internet into their

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[21] *Id.* at para. 83.

[22] *Core Forbearance Order* at para. 20.

[23] *Id*. at para. 20 n. 56.

daily lives. The plain truth is that the factual lynchpin underlying the Commission's *Core Forbearance Order* is nothing more than pure conjecture that has no support in the record.

In fact, what evidence there is in the record demonstrates that the Commission's conjecture is, in fact, incorrect. Specifically, an October 1, 2004, *ex parte* from BellSouth demonstrates that even as the "number of dial-up subscribers has declined with the growth in broadband, the level of dial-up minutes of use has not."[24] BellSouth provided the Commission a chart from an industry study demonstrating that dial-up minutes increased steadily from 1999 to 2002, dipped slightly in 2002, and were projected to grow again at least through 2007.[25] An October 5, 2004, *ex parte* filed by Qwest similarly demonstrated that its dial-up ISP-bound traffic had increased substantially since 2001.[26]

These data are consistent with SBC's experience. Despite the measures adopted in the *ISP Remand Order* to eliminate the market distortions and regulatory arbitrage opportunities caused by per-minute reciprocal compensation for ISP-bound traffic, CLECs still terminate more than *nine times* more traffic than they originate to SBC. If the Commission's decision to lift the new market rule and growth cap goes into effect, SBC's net reciprocal compensation payments would immediately increase approximately 20 percent; and that does not include any potential growth in ISP-bound traffic that might result from lifting the caps. Simply put, the Commission's supposition that its *Core Forbearance Order* will not enlarge the "arbitrage opportunity presented by ISP-bound traffic,"[27] is, as a matter of fact and logic, incorrect.[28]

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[24] Letter from Herschel L. Abbot, Jr., Vice President-Government Affairs (BellSouth Corporation) to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 96-98, 99-68 (Oct. 1, 2004).

[25] *Id.*

[26] Letter from Andrew D. Crain, Associate General Counsel (Qwest) to Marlene H. Dortch, Secretary, Federal Communications Commission, Docket Nos. 96-98,03-171, at 4 (Oct. 5, 2004).

[27] *Core Forbearance Order* at para. 20.

[28] *See* Letter from Eric Einhorn, Executive Director-Federal Regulatory (SBC) to Marlene H. Dortch, Secretary, Federal Communications Commission, Docket Nos. 96-98, 99-68, 01-92 (Oct. 1, 2004)("simply lifting the caps without any offsetting reduction in the interim rate would be inconsistent

Unless ISP-bound minutes, not only stop growing, but decline enough to erase all the growth that has taken place since 2001, a lifting of the caps will exacerbate the very types of arbitrage opportunities and market distortions the *ISP Remand Order* sought to limit.

Of course, even if the Commission was correct in its assumptions that dial-up Internet minutes had declined, the Commission failed to consider how the lifting of the growth caps would affect *future* dial-up minutes. The Commission has found that the availability of intercarrier compensation for ISP-bound traffic distorts markets by creating arbitrage opportunities. Indeed, it found that the record "strongly suggests that CLECs target ISPs in large part because of the availability of reciprocal compensation payments and that some have even engaged in fraudulent schemes to generate additional Internet traffic."[29] Lifting the growth and new market caps will revive and enlarge the very opportunities for regulatory arbitrage and market distortion that the Commission set out to curtail in the *ISP Remand Order*.[30] That prospect is perhaps demonstrated most starkly by fraudulent schemes CLECs have concocted in the past to generate ISP minutes solely to collect reciprocal compensation payments. Indeed, in a particularly noteworthy and elaborate illustration of such schemes, one CLEC induced other companies to originate connections to BellSouth's network and terminate them to the CLEC with

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with the *ISP Remand Order* transition and the policy concerns that led the Commission to establish the interim rate in the first place."); Letter from Eric Einhorn, Executive Director-Federal Regulatory (SBC) to Marlene H. Dortch, Secretary, Federal Communications Commission, Docket Nos. 96-98, 99-68, 01-92 (Oct. 7, 2004)("lifting the growth and/or new market caps would expand the ISP-bound traffic subject to intercarrier compensation, reviving opportunities for regulatory arbitrage and market distortion that the Commission set out to curtail in the *ISP Remand Order*, and thus would be a significant step in the wrong direction.").

[29] *ISP Remand Order* at para. 70.

[30] The *Core Forbearance Petition* itself was essentially a demand that the Commission repudiate entirely the policy goals, as well as the economic principles underlying those goals, set forth by the Commission in its *ISP Remand Order*. The gravamen of the *Core Forbearance Petition* was that the Commission's *ISP Remand Order* interferes with CLEC business plans "heavily dependant upon the CLECs' ability [sic] recoup embedded costs, in part, through the collection of reciprocal compensation revenues." *Core Petition* at 6. Eliminating CLEC dependence on intercarrier compensation payments, however, was precisely the Commission's objective, and was the whole point of the Commission's *ISP Remand Order* in the first place.

routers installed to keep those circuits "nailed up" 23 hours and 59 minutes every day, solely for the purpose of generating ISP-bound traffic and to collect reciprocal compensation for that traffic.[31] But even if CLECs do not engage in outright fraud, eliminating the growth cap without lowering the compensation rate for ISP-bound traffic will give CLECs every incentive to employ every other possible means to increase the number of dial-up ISP-bound traffic.[32] Thus, the lifting of the caps and the elimination of the new market rule themselves are likely to increase dial-up minutes, irrespective of recent trends.

For that reason alone, the *Core Forbearance Order* is fundamentally incompatible with the principles underlying with the *ISP Remand Order*. The Commission adopted the interim rate and other components of the *ISP Remand Order* specifically because it found that requiring intercarrier compensation for ISP-bound traffic creates regulatory arbitrage opportunities and distorts the development of competitive markets by divorcing cost recovery from the ultimate consumer of services, contrary to the goals of the Act. The Commission thus adopted the growth and new market caps because "allowing carriers in the interim to expand into new markets . . . would exacerbate the market problems [the Commission sought] to ameliorate."[33] The purpose of the growth cap and the new markets rule (as well as was the rate caps and mirroring rule) was to prevent the regulatory arbitrage created by the prospect of intercarrier payments for ISP traffic and thus move not merely to *any* comprehensive compensation regime, but specifically to *bill-and-keep*.[34]

[31] *See* BellSouth Telecommunications, Inc. v. US LEC North Carolina, *Order Denying Reciprocal Compensation*, State of North Carolina Utilities Commission, Docket No. P-561, Sub 10 (March 31, 2000).

[32] As one North Carolina Utilities Commissioner put it, "Some will argue that the US LEC/Metacom scheme was simply a clever and innovative mechanism resulting from the introduction of competition in public telecommunications. While clever, the scheme is not particularly innovative, deriving from a certain snake which convinced a certain woman that a certain fruit would be good for her." *Id.* (Comm'r Pittman concurrence at 2).

[33] *ISP Remand Order* at para. 81.

[34] *Id.* at para. 86.

In its *Core Forbearance Order,* the Commission did not repudiate, and in fact reiterated, that underlying purpose of the *ISP Remand Order*.[35] Its *Core Forbearance Order* thus is internally inconsistent. The Commission cannot, on the one hand, seek to prevent regulatory arbitrage and maintain a transition to a bill-and-keep compensation structure, while simultaneously removing two of the pillars on which that structure rests. Accordingly, the Commission should reconsider its *Core Forbearance Order* and retain the growth cap and new markets rule established in its *ISP Compensation Order*.

If the Commission nevertheless determines that removing the growth cap and new market rule is appropriate to address concerns that those rules might distort competition by allowing some, but not other, CLECs to obtain compensation for ISP-bound traffic, it should take countervailing steps so as not to undermine the transition it began in its *ISP Remand Order.* The most logical step would be for the Commission to reduce the interim rate for ISP-bound traffic so as to offset the effect of the *Core Forbearance Order*. The Commission could accomplish this by simply establishing a lower rate, as SBC proposed prior to the issuance of the *Core Forbearance Order*.[36] In fact, the ICF recommended a similar path for addressing this issue in the context of more global reform of intercarrier compensation.

At a minimum, the Commission should condition its grant of forbearance. Specifically, it should require any carrier that seeks compensation for ISP-bound traffic that would not have been compensable under the growth cap or new markets rules to accept a lower rate for terminating all ISP-bound traffic. Such conditional forbearance would allow CLECs who feel

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[35] *Core Forbearance Order* at paras. 18-19.

[36] *See* Letter from Eric Einhorn, Executive Director-Federal Regulatory (SBC) to Marlene H. Dortch, Secretary, Federal Communications Commission, Docket Nos. 96-98, 99-68, 01-92 (Oct. 1, 2004)("if the Commission deems it necessary to remove the caps, it should continue the transition by modifying the interim rate for ISP-bound traffic consistent with the ICF plan"); Letter from Eric Einhorn, Executive Director-Federal Regulatory (SBC) to Marlene H. Dortch, Secretary, Federal Communications Commission, Docket Nos. 96-98, 99-68, 01-92 (Oct. 7, 2004)("if the Commission deems it necessary to remove the new market and/or growth caps, it should continue the transition by modifying downward the interim rate for ISP-bound traffic consistent with the ICF plan").

unfairly disadvantaged by the growth and new market caps to avoid those limits, while preventing back-sliding toward the skewed incentives and market distortions that those limits were designed to address.

IV. CONCLUSION

The Commission has recognized that intercarrier compensation for ISP-bound traffic distorts the market and creates a barrier to competition. Allowing carriers to expand into new markets and collect additional reciprocal compensation revenues from ISP-bound traffic does not serve the public interest and is inconsistent with the Commission's *ISP Intercarrier Compensation Order*. The Commission's decision removing the growth cap and new markets rule is, moreover, unsupported by evidence in the record. For these reasons, the Commission should promptly reconsider its decision forbearing from application of those rules. In the alternative, if the Commission eliminates the growth cap and new markets rule, to remain faithful to the policies underlying its *ISP Remand Order*, the Commission should establish a lower rate for intercarrier compensation payments for ISP-bound traffic, if not for the entire industry, then at least for those CLECs that do not abide by the growth caps or new market rules..

Respectfully Submitted,

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